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C O N F I D E N T I A L SECTION 01 OF 03 MOSCOW 000251

SIPDIS

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TAGS: [EMIN](#) [ECON](#) [PREL](#) [RS](#) [CH](#)

SUBJECT: NOT QUITE A WHOLE NEW ERA FOR RUSAL

REF: HONGKONG 113

Classified By: EconMinCouns Matthias J. Mitman, Reasons 1.4 (b,d)

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SUMMARY  
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¶1. (C) After restructuring billions in debt, Rusal raised USD 2.2 billion through its January IPO in Hong Kong. Rusal executives see the restructuring and listing as key steps in the company's transition into a modern, public company. Despite its achievements, Rusal will have to cope with restrictions on its operations stemming from the restructuring as well as the potential loss of one of its facilities in Guinea. Rusal CEO Oleg Deripaska also faces a court case in the UK over a 13 percent stake in the company. Recent press reports alleging Rusal involvement in hacker attacks on a Russian newspaper and surveillance of a free-lance journalist have further tarnished the company's image. However, analysts downplayed the degree of difficulty Rusal would have dealing with these issues as well as their influence on investors' decisions. They do not foresee significant changes in company management. Based on Rusal's experience as an example of the Russian approach to corporate debt and inefficiency, genuine reform and improvements in corporate governance are less likely if market conditions reduce financial incentives to make those changes. End Summary.

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RUSAL EMERGES AS A PUBLIC COMPANY  
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¶2. (U) At the end of 2009, Rusal, the world's largest producer of aluminum and alumina, concluded restructuring agreements for USD 14.9 billion in debt, linking repayment to the company's ability to generate excess cash flow. The agreements extended the maturity of Rusal's obligations to foreign lenders until 2013, with an option to refinance for an additional three years. Mikhail Prokhorov's Onexim group agreed to convert USD 1.8 billion in debt into equity for an additional six percent stake in the company. Arrangements for the remaining USD 880 million in Onexim debt and Rusal's debts to other Russian and Kazakh lenders largely mirror the repayment and pricing terms of the international debt. In addition, Rusal received a one-year extension on USD 4.5 billion in debt owed to state-owned Vnesheconombank (VEB) and an unconditional commitment from state-owned Sberbank to assume all obligations under the loan and extend its maturity to the end of 2013, upon the company's request.

¶3. (U) On January 27, Rusal completed its initial public

offering (IPO) of 10.6 percent of the company's shares on the Hong Kong Stock Exchange (reftel). With a final stock price of HK 10.80 (USD 1.39), Rusal raised USD 2.2 billion through the IPO. Despite a hefty minimum subscription of HK 1 million (USD 129,000), employees of the banks organizing the IPO told Russian business daily "Vedomosti" that Rusal had attracted over 300 new shareholders. VEB made the largest purchase, investing USD 663 million for a 3.15 percent stake in the company. Other major investors included Nathaniel Rothschild, John Paulson, Robert Kuok, and the Libyan Investment Authority. Although Sberbank had expressed interest in the IPO, it did not participate. Rusal will use funds from the IPO solely to repay its debts (USD 115 million will go to Onexim, and the rest to Western banks). The company's stock fell approximately nine percent during the initial trading period after the IPO, but analysts attributed the drop to the general fall in metal company stock prices, which had declined similarly since Rusal's price was set on January 22.

14. (C) During a meeting on January 15, Sergey Chestnoy and Andrey Arseniev of Rusal's Department of International Cooperation told us they were happy to see Rusal become a public company and leave behind the "Ministry of Aluminum" style of doing business. While he did not expect significant management changes as a result of the IPO (and the decrease in CEO Oleg Deripaska's share to 47 percent), Chestnoy stated that he had started to see improvements as the company began to implement the conditions of the restructuring. He also noted that bad managers had become easier to identify during the financial crisis than during the preceding boom.

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Chestnoy would like to see Rusal attract even more shareholders in the future. In addition, he emphasized the company's improving environmental performance, underscoring Rusal's target of 99.5 percent clean emissions from its Russian facilities.

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DEBTS, LEGAL PROCEEDINGS, AND RUMORS CLOUD FUTURE  
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15. (U) According to Rusal's IPO prospectus, its debt restructuring agreements will limit its operational and financial freedom during the repayment period. The company will be unable to incur any development capital expenditure, except with respect to the Boguchanskaya hydropower plant or to comply with environmental law. The agreements also restrict dividends. In addition, Rusal will have to repay debt using the proceeds of its equity sales. Small changes in the cost of inputs, price of aluminum, or RUR/USD exchange rate could result in the company's inability to comply with one or more of the financial covenants and debt reduction targets (Note: The GOR plans to liberalize electricity prices, a major cost factor in the aluminum production process, in January 2011. End Note).

16. (C) Rusal is currently involved in a dispute with the government of Guinea (GOG) over the legitimacy of the purchase of a bauxite mine and an alumina refinery. Rusal operates three bauxite mining and alumina refining facilities in Guinea, which holds two-thirds of the world's bauxite deposits. A Guinean court ruled that the 2006 sale to Rusal of an alumina refinery formerly controlled by a Guinean state corporation was illegal on the grounds that Rusal paid significantly less than the plant's true value. Rusal claims its acquisition was in full compliance with the law at the time of purchase. In September 2009, the GOG banned Rusal from exporting for almost a week over the dispute. The GOG is already seeking to sell the plant to new owners. According to press reports, the GOG is also demanding up to USD 860 million of Rusal's earnings from its IPO to cover damages owed. In January, Rusal stakeholder Victor Vekselberg told the press that the company was in discussions with the GOG and expected a settlement reasonably soon.

However, Chestnoy told us that Rusal was limited in its ability to negotiate with the GOG because the current government is "not legitimate." He said that Rusal was waiting for a resolution of the political situation in the country before concluding an agreement over the facility.

17. (SBU) Rusal CEO Oleg Deripaska also faces a court case in the UK over a 13 percent stake in the company. In November 2006, Michael Cherney (Mikhail Chernoy) filed a claim against Deripaska in a London court over the alleged breach or repudiation by Deripaska of alleged contractual commitments to sell for Cherney's benefit 20 percent of Rusal Limited, now a wholly owned direct subsidiary of UC Rusal. Cherney is seeking an order that Deripaska sell the shares he is owed and account to Cherney for the proceeds of the sale. Deripaska will have to serve a defense to Cherney's claim early in 2010. Press reports quote Deripaska describing the case as "crap" and "blackmail." The judge overseeing the case has indicated that Cherney has a reasonable prospect of success.

18. (C) Recent press reports have alluded to possible connections between Rusal and attacks on Vedomosti and an Australian-American journalist residing in Moscow. In December, hackers conducted denial of service attacks on the Vedomosti website and interfered with some journalists' cell phones. Press reports alleged that the attacks were connected to an October article in Vedomosti on Rusal's financial losses and attempts to "hide" profits. Vedomosti Editor Elizaveta Osetinskaya claimed Rusal lawyers threatened legal action against the paper for revealing "commercial secrets." Also in December, authorities detained three armed men outside the home of Australian journalist John Helmer a week after the Australian government had warned him that it had confidential information he was in danger. Helmer claimed that he was targeted because of his aggressive reporting on Rusal CEO Deripaska and said that Russian police told him the men arrested claimed to work for a private security company acting on behalf of Rusal. A Rusal representative told the press that Helmer's claims were unfounded, and Rusal's Chestnoy told us "what Helmer needs is

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a psychiatrist."

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EXPERTS DOWNPLAY OBSTACLES BUT DO NOT EXPECT NEW COMPANY  
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19. (C) Assuming commodity prices continue to strengthen, analysts do not anticipate that Rusal's financial and legal issues will present major barriers to the company's growth. During a meeting on January 27, Stewart Lawson, HSBC Russia CEO and a former employee of Deripaska's Basic Element holding company (please protect), dismissed Rusal's current debt situation, particularly with regard to Russian state banks, noting that the chairman of VEB is not far from Deripaska's interests, and thus the VEB loan will never come due. He was also clear that Rusal had been able to negotiate deals with its foreign lenders because its debts were so large, and if they chose not to restructure, the foreign lenders would have lost even more. Regarding the Cherney case, Deutsche Bank analyst Olga Okuneva told us on January 14 that investors think the Cherney case is old news and do not factor it into their decisions. Lawson was also convinced that Cherney was firmly in Rusal's past, declaring "Cherney is a thug, they're (Cherney and Deripaska) both thugs, you don't end up running the Russian aluminum business without being a thug. But, Deripaska is one of the smartest guys in business I have met. He (Deripaska) will have to pay a couple hundred million or do a deal to resolve the Cherney case, but Deripaska loves London and wants to go there, so he will."

10. (C) Lawson doubted Rusal would undergo an evolution into a transparent, modern corporation as a result of its

restructuring or the IPO. He discounted the influence of new shareholders over the company, claiming that, "minority shareholders don't get squat in Russia." In addition, Lawson said that Deripaska did not have a "big dictionary" of corporate governance. In Lawson's view, Deripaska would enact reforms only to the extent he thought he could personally benefit from them.

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COMMENT

11. (C) Lawson's observation that Deripaska (and other powerful Russian oligarchs) only act in their own short-term, monetary interests -- as opposed to the long-term maximization of shareholder value -- highlights the need to convince these leaders that integration into the global economy and the resultant corporate governance reforms will be in their long-term self-interest. Unfortunately, Rusal serves as a good illustration of the GOR's and major Russian corporations' current approach to surviving in a globalized economy. Instead of sincere attempts to modernize and reform companies into efficient, transparent corporations, the goal is to restructure and extend debt, buying time until commodity prices rise and inefficiencies become less important. The GOR has also managed to increase its stake in key companies and sectors by swapping state-owned banks' debt for equity. As recent economic indicators point to a rebound in the Russian manufacturing sector, we expect major companies to face even less pressure for restructuring or reforming their operations. End Comment.  
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